No. 13220

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

CARMELO J. PELLEGRINO,

Appellant,

vs.

WILLIAM D. NESBIT, HUGH F. COLVIN, JAMES R. BRADBURN, and CONSOLIDATED ENGINEERING CORPORATION,

Appellees.

BRIEF OF CONSOLIDATED ENGINEERING CORPORATION, APPELLEE.

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Jurisdiction.

The complaints herein, filed on November 21, 1950, set forth the facts showing the existence of the jurisdiction of the District Court. [R. pp. 3, 28, 51.] Jurisdiction of the District Court is derived from Section 27 of the Securities Exchange Act of 1934, 15 U. S. C. A., Section 78aa. Jurisdiction of the Court of Appeals is derived from the Judicial Code, 28 U. S. C. A., Sections 1291, 1294.

Statement.

Appellant, Pellegrino, has appealed from an order of the District Court of the United States, Southern District of California, Central Division, entered November 29, 1951, denying his motion for leave to intervene for the

purpose of appealing from judgments entered October 30, 1951, in favor of the named individual appellees herein. [R. pp. 117-118.] In support of his appeal appellant has filed an Opening Brief in which he has made allegations and drawn inferences with respect to his "right" to appeal. As a result Consolidated Engineering Corporation, the plaintiff below and one of the appellees herein, hereinafter sometimes referred to as "Consolidated," feels impelled to file this Brief.

Consolidated will direct its attention solely to one issue, and particularly to appellant's conclusions thereon, the same issue, differently phrased, having been presented and argued by appellant in his Opening Brief (pp. 3-10).

Issue Presented.

Was appellant's interest adequately represented by Consolidated?

Argument.

Introductory.

Consolidated does not propose to argue herein the merits of the judgments entered by the District Court in these actions, nor does it propose to argue the question of whether said judgments, on their merits, are properly before the Court of Appeals, nor does it propose to argue whether appellant's motion to intervene was a timely one. However, Consolidated does dispute the contention of appellant that his interests, and, indeed, of all of Consolidated stockholders, have not been adequately represented throughout. Appellant's contention that he is entitled to intervene and prosecute appeals from the judgments below *as a matter of right,* because his

interest was inadequately represented by Consolidated, is without support. It is based on inferences and conclusions wholly unsupported in fact or in law, and particularly unsupported by the Record on Appeal. This Court should not be called upon to make findings on the basis of such unsupported inferences and conclusions.

I.

The Interests of Consolidated, and Its Stockholders, Were Adequately Represented by Consolidated in the District Court.

Rule 24(a)(2) of the Federal Rules of Civil Procedure provides that:

> "(a) Intervention of Right. Upon timely application anyone shall be permitted to intervene in an action: * * * (2) when the representation of the applicant's interest by existing parties is or may be inadequate and the applicant is or may be bound by a judgment in the action; * * *."

Appellant asserts a right to intervene derived from the above Rule (App. Op. Br. pp. 6, 7). However, he has failed to establish one of the requisites for the application of that Rule, namely, that "the representation of the applicant's interest by existing parties is or may be inadequate." Such inadequacy must be shown to exist before intervention is authorized. (*MacDonald v. United States*, 119 F. 2d 821 (9th Cir., 1941).)

Appellant suggests in his Brief (p. 7) that the Board of Directors of Consolidated "could hardly be expected to zealously prosecute any action" against the defendants herein because they were appointed as officers of the corporation by the Board. This is a patent *non sequitur*.

As appellant's Brief (p. 6) points out, it is a "cardinal principle of law that the Board of Directors of a corporation is the representative of its stockholders. It is the duty of the Board to protect and foster the interests of the corporation and its stockholders." As a consequence, when a Board of Directors employs an officer in a position of responsibility, the logical conclusion (contrary to that urged by appellant) is that the Board will hold that officer strictly accountable for all of his actions concerning the corporation and its affairs.

To be sure, if the employee controls or dominates the Board of Directors, a different conclusion might be justified. Perhaps with this thought in mind, appellant has cited in his Brief (p. 7), *Park & Tilford, Inc. v. Schulte*, 160 F. 2d 984 (2nd Cir., 1947), cert. denied, 332 U. S. 761, 68 Sup. Ct. 64 (1947), as a case "on all fours" with the present one. However, the vital facts in that case are clearly different from those herein. They point up the distinction between representation of a stockholder's interest by the corporation when the defendant controls or dominates it and when he does not. Here there was no such control or domination.

In the *Park & Tilford* case, *supra,* the District Court's order denying the stockholder's motion to intervene in an action to recover, under Section 16(b) of the Securities Exchange Act of 1934 (15 U. S. C. A., Sec. 78p(b)),* "short swing" profits realized by certain principal stockholders was reversed on appeal by the Court of Appeals for the Second Circuit. That Court emphasized the dominance exercised by the defendants and their father,

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*See *infra,* page 7.

and the interests which they represented, over Park & Tilford. The defendants in that case were brothers who were trustees for a trust created by their father. He, in turn, was a former president of Park & Tilford, and was chairman of its Board of Directors in 1945, which was between the time of the purchases and sales by the defendants giving rise to the litigation and the time the Court of Appeals reversed the denial of the stockholder's motion to intervene. In addition, and more important, the defendants themselves controlled the corporation through ownership of a majority of the common voting stock. They also owned a sizeable block of preferred stock, convertible into common stock. Such facts (obviously different from those in the present case) virtually compelled the conclusion which was reached.

By way of contrast, examination of the Record on Appeal in this litigation discloses no suggestion of concerted action. There is nothing which shows dominance or control of Consolidated by the defendants. There is nothing even remotely suggesting that Consolidated's Board of Directors, responsible as it was and is to its stockholders, has failed or would fail to protect, in every way, the best *and the real* interests of Consolidated and its stockholders.

Between March 1, 1949, and April 20, 1950, Consolidated had at least 174,190 shares of stock outstanding, of which, during the same period, Nesbit and his wife owned no more than 2,000 shares. [R. p. 19.] Between March 25, 1949, and August 9, 1950, Consolidated had at least 176,790 shares of stock outstanding, of which, during the same period, Colvin and his wife owned no more than 1,420 shares. [R. p. 42.] Be-

tween March 24, 1949, and April 25, 1950, Consolidated had at least 176,790 shares of stock outstanding, of which, during the same period, Bradburn and his wife owned no more than 2,100 shares. [R. p. 67.] Thus, the combined stock holdings of Nesbit, Bradburn, and Colvin, and their wives, during the periods when the purchases and sales giving rise to this litigation were made, constituted less than 4% of the total outstanding stock of Consolidated. There is no evidence in the record, by affidavit of appellant, or otherwise, that the proportionate interests of those individuals, or their wives, have changed since the above mentioned dates. Neither is there any showing of control or dominance of the affairs of Consolidated.

During the time of the transactions here involved Nesbit and Bradburn were vice-presidents [R. pp. 4, 51], and Colvin was the treasurer of Consolidated. [R. p. 28.] However, there is no evidence in the record, by affidavit of appellant, or otherwise, that these officers, or any of them, made or influenced any decisions involving corporate policy such as those made by Consolidated's Board of Directors in initiating these actions, prosecuting them diligently to judgment, and deciding not to appeal. Neither is there any showing that any of the three, nor all three together, had such power. There is no evidence in the record that these officers, nor any one of them, were members of the Board of Directors of the corporation at any material time, nor at any time, nor in any way related to or affiliated with any members of said Board. Had any domination of the Board of Directors by the three defendants existed (which, of course, it did not in fact) it is the appellant's respon-

sibility to bring before this Court a record so demonstrating.

It is abundantly clear that this case is not on all fours with the *Park & Tilford* case, *supra*. The present case is so distinguishable on its facts as to make the *Park & Tilford* case no authority whatsoever for appellant's contention.

It should be noted in passing that the Securities and Exchange Commission appeared below as a friend of the Court [R. p. 85] and assisted Consolidated in representing its interests and those of its stockholders. Yet no suggestion has been made by the Commission that Consolidated failed to discharge its function adequately.

II.

Consolidated's Board of Directors Acted in the Best Interests of, and Adequately Represented, the Corporation and Its Stockholders by Deciding in Good Faith Not to Appeal From the Judgments of the District Court.

Section 16(b) of the Securities Exchange Act of 1934, 15 U. S. C. A., Section 78p(b) provides:

> "For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the

part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or *shall fail diligently to prosecute the same thereafter*; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection." (Emphasis added.)

This section confers a right upon a stockholder to institute suit on the corporation's behalf to recover "short swing" profits, provided that the corporation fails to commence such suit within sixty days after request or *fails diligently to prosecute the same thereafter.*

As already stated herein, appellant has failed completely to show a failure of Consolidated to adequately represent the interests of its stockholders in prosecuting the suits against the defendants herein to judgment. Such prosecution was diligent notwithstanding that it resulted in judgments for the three defendants. But appellant urges that Consolidated must appeal the judgments or be deemed "non-feasant" in its duty. (App. Op. Br. p. 6.)

Appellant seeks to usurp the function of the Board of Directors. A corporation's Board of Directors is required by law to exercise its best judgment in directing corporate affairs. Surely one of its functions is to decide whether to appeal from judgments in favor of defendants against whom the corporation has brought suit. Consolidated was well aware of the mandate in the Securities Exchange Act, Section 16(b), *supra,* to institute suits against the defendants and thereafter prosecute them diligently. This Consolidated has done, and judgments have been entered. However, it is an entirely different proposition that the appellant now urges. He contends that Consolidated must appeal from the judgments whether or not the Board of Directors determines, in good faith, that it would not be to the best interests of the corporation and its stockholders to do so; whether or not any evidence of collusion exists or existed before the trial court; and whether or not dominance, control or influence by the defendants of the decision of the Board of Directors not to appeal existed, exists, or was a possibility. This must be appellant's contention, although he has not stated it in so many words, because there is no evidence in the record, by affidavit, or otherwise, which even suggests a failure of Consolidated's Board of Directors to determine, in good faith, that an appeal would not be to the best interests of the corporation and its stockholders. Neither is there anything which even suggests the existence of concerted action in the proceedings before the District Court, or dominance, control or influence by the defendants of the decisions of the Board of Directors.

Appellant cites several cases. At page 9 of his Opening Brief he refers to *Wolpe v. Poretsky,* 144 F. 2d 505,

508 (C. A. D. C. 1944), cert. denied, 323 U. S. 777, 65 Sup. Ct. 190 (1944), in which case intervention was allowed after a final decree for the purpose of permitting an appeal. In that case adjoining property owners were permitted to intervene to take an appeal from a decision that a zoning order of a Zoning Commission was arbitrary, capricious and void. The Court stated at page 508:

> "We only indicate that there is enough in the record to show that in refusing to take an appeal the Commission did not adequately represent the intervener's interests."

However, the Court also said at page 507 (a statement conveniently omitted from the reference to the case in App. Op. Br.),

> "We do not go so far as to hold that adequate representation requires an appeal in every case."

There is nothing in the record here to indicate that Consolidated's failure to take an appeal constituted inadequate representation of the stockholders' interests.

Other cases cited in Appellant's Opening Brief with respect to the duty to appeal from judgments deserve only passing comment. In *Brotherhood of Railroad Trainmen v. Baltimore & O. R. Co., et al.,* 331 U. S. 519. 67 Sup. Ct. 1387 (1947), a statute gave the right to intervene; and the Court did not decide the issue on the basis of Rule 24(a)(2) of the Federal Rules of Civil Procedure. In *Klein v. Nu-Way Shoe Co.,* 136 F. 2d 986 (2nd Cir., 1943), collusion was alleged between a bankrupt and the creditors with the result that the stockholder was permitted to intervene. As previously

pointed out, there is no evidence of the existence of, nor the possibility of, collusion in this litigation. In *Missouri-Kansas Pipe Line Co. v. United States,* 312 U. S. 502, 61 Sup. Ct. 66 (1941), the stockholder's motion made appropriate allegations as to the unwillingness of those responsible for the actions of the corporation to protect its interests. No such allegations have been made, nor could justifiably be made, herein.

The reasons which could motivate a Board of Directors to decide, in good faith and in the best interests of the corporation and its stockholders, not to appeal from judgments of the nature herein involved are myriad. To enumerate a few: (1) the additional expense and time involved; (2) the uncertainty of success on appeal; (3) the effect of further harassment of the defendant employees upon not only those employees but all employees of the corporation, and the consequent effect upon the production, business, and welfare of the corporation; (4) the unfavorable reaction of the stockholders of the corporation in general, including stockholders with large as well as small holdings. These motives or similar ones, must be ascribed to the action of Consolidated's Board of Directors since appellant has failed completely to show the contrary by affidavit or otherwise.

Consolidated does not propose to argue whether the appellant's interest is "substantial" as he states in his Opening Brief (p. 6), or to argue whether the substantiality of his interest is material to a determination of his right to intervene. However, it should be ob-

served that appellant's interest in Consolidated was acquired only twenty-one (21) days before he requested the institution of these actions [R. pp. 112-113], and at the time of his motion to intervene his interest was limited to the ownership of *two shares of stock.* [R. p. 113.] As far back as March, 1949, Consolidated had a minimum of 174,190 shares outstanding. [R. p. 19.] Appellant must be speaking of some interest other than his stock ownership, for certainly that interest is not substantial. Whether it is a purely personal interest, or possibly that of his counsel, is in the realm of conjecture—a realm with which this Court should not be concerned. Be that as it may, it is submitted that Consolidated and its Board of Directors have adequately represented the interests of the corporation and all of its stockholders throughout this litigation, including the decision not to appeal the judgments herein. It is further submitted that Rule 24(a)(2) of the Federal Rules of Civil Procedure, *supra,* with respect to the right of intervention when applied to this situation refers solely to representation of applicant's interest *as a stockholder* in the corporation, and not to any interest applicant may have in personal gain separate and apart from a proportionate interest based on his stock ownership in any corporate recovery.

Consolidated urges that this Court recognize the fact that it has complied with the mandate of Section 16(b) of the Securities Exchange Act that suits be instituted and diligently prosecuted. Consolidated further urges

that this Court recognize that after such prosecution, the policy of the statute and principles of equity and justice not only permit but demand that the Board of Directors of the corporation shall, in good faith, have the discretion to determine whether or not an appeal should be taken. To find otherwise would mean that any stockholder, no matter how small his interest, could usurp the function of the directorate of a corporation elected by the majority of its owners, the stockholders.

Conclusion.

Appellant's interest was adequately represented by Consolidated.

Respectfully submitted,

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